DEPARTMENT OF STATE REVENUE
SUPPLEMENTAL LETTER OF FINDINGS: 98-0675SLOF
Indiana Gross Income Tax
For the Tax Years 1993 and 1994

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ISSUE

I. Gross Income Tax – Telecommunications Services.

Authority: U.S. Const. art. I, § 8; IC 6-2.1-1-13; IC 6-2.1-2-2; IC 6-2.1-3-3; 45 IAC 1-1-124(b); Monarch Steel Co. v. State Bd. Of Tax Comm'r, 699 N.E.2d 809 (Ind. Tax Ct. 1998); Indianapolis Public Transp. Corp. v. Indiana Dept. of State Revenue, 512 N.E.2d 906 (Ind. Tax Ct. 1987).

Taxpayer argues that it is a carrier of interstate telecommunications and that the income it received from the interstate communication of telecommunications was not subject to the state's gross income tax.

STATEMENT OF FACTS

Taxpayer is in the business of providing private line telecommunication transmission services to long distance carriers. Using the jargon of the telecommunications industry, taxpayer is a "facilities-based interexchange carrier" of voice and data information. As that term is used in the industry, taxpayer is a carrier which owns most of its equipment and transmission lines and provides long distance telephone service between LATA's (Local Access and Transport Areas). In order to provide its services, taxpayer operates a microwave transmission network on a regional basis. That network consists of microwave transmitters, receivers, towers, antennae, auxiliary power equipment, and equipment shelters.

When taxpayer computed its Indiana gross income, taxpayer included only the receipts from transporting "intrastate" communications and excluded that income attributable to "interstate communications. Taxpayer reported only that gross income derived from transporting communications over transmission segments that originated and terminated within Indiana.

Audit disagreed with taxpayer's reporting method. The audit determined that taxpayer was not a "communications carrier" but was a mere service provider and, consequently, could not adopt the definition of "intrastate" applicable to "communications carriers." Audit concluded that taxpayer operated to provide ancillary communication services to the actual "communications carriers." The ancillary nature of taxpayer's activities required that taxpayer report, as gross income, all receipts attributable to its Indiana activities. As a result, audit proposed additional assessments of gross income tax. Taxpayer protested both the audit's conclusions and the

additional assessments. A hearing was held and a Letter of Findings was prepared and issued by the Department. The Letter of Findings agreed with the audit's conclusions finding that taxpayer was not "carrying communications" but was providing an intermediate service to long distance carriers. The taxpayer requested a rehearing on the issues, an administrative hearing was held, and this Supplemental Letter of Findings followed.

DISCUSSION

I. Gross Income Tax – Telecommunications Services.

Under IC 6-2.1-2-2, Indiana imposes "[a]n income tax, known as the gross income tax . . . upon the receipt of: (1) the entire taxable gross income of a taxpayer who is a resident or a domiciliary of Indiana; and (2) the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or a domiciliary of Indiana." A taxpayer's gross income includes all gross income not specifically exempted. IC 6-2.1-1-13.

The Department's regulation provides such an exemption which is central to the taxpayer's protest. 45 IAC 1-1-124(b) provides as follows:

> Income from wire communications, including telephone and telegraph lines is taxable if derived from carrying communications between two (2) points in Indiana. It is not taxable if derived from carrying communications between a point outside Indiana and a point in Indiana, or from a point outside Indiana into and across the state to a point outside Indiana. *(Note: 45 IAC 1 was repealed effective January 1, 1999, and replaced by 45 IAC 1.1).*

In addition to the specific exemptions allowed within the gross income tax scheme, IC 6-2.1-3-3 codifies the constitutional prohibition placed upon the individual states by the Interstate Commerce Clause. U.S. Const. art. I, § 8. Specifically, IC 6-2.1-3-3 provides that "Gross income derived from business conducted in commerce between the state of Indiana and either another state or a foreign country is exempt from gross income tax to the extent the state of Indiana is prohibited from taxing that gross income by the United States Constitution." It would seem apparent that 45 IAC 1-1-124(b) is an attempt to meet the constitutional requirement codified at IC 6-2.1-3-3.

Taxpayer provides its services to primary long distance carriers. That service is provided to fill in the gaps in the primary carrier's own transmission system or to provide additional capability when the primary carrier's system lacks available capacity to carry the amount of potential traffic. Once the taxpayer's customers route their communications signal into the taxpayer's system, it is the taxpayer who has the responsibility for carrying that signal between the designated points. Taxpayer's system is essentially a "fill in the gap" service. These "gaps" may be between two different points within Indiana (Indianapolis to Bloomington) between a point within Indiana and a point outside Indiana (Indianapolis to Chicago); or a gap which traverses Indiana (Chicago to Cleveland).

It is not disputed that the money taxpayer received from carrying communications between two points located within the state (Indianapolis to Bloomington) is subject to the gross income tax. However, taxpayer argues that the money it received for carrying communications between a

point within Indiana to a point outside Indiana and the money it received for carrying communications across the state is, under 45 1-1-124(b), exempt from the gross income tax tax.

When discussing tax exemptions, such as 45 IAC 1-1-124(b), the courts have held that the exemptions are strictly construed against the taxpayer and in favor of taxation. Monarch Steel Co. v. State Bd. Of Tax Comm'r, 699 N.E.2d 809, 811 (Ind. Tax Ct. 1998). Trinity Episcopal Church v. State Bd. Of Tax Comm'r, 694 N.E.2d 816, 818 (Ind. Tax. Ct. 1998).

Nonetheless, however stringently 45 IAC 1-1-124(b) is construed or however finely the language of 45 IAC 1-1-124(b) is parsed, taxpayer is entitled to the regulatory exemption.

The plain words of 45 IAC 1-1-124(b) state that a carrier is entitled to the exemption when it carries telecommunications information from a point within Indiana to a point outside the state or if the information is carried across the state. The audit and the original Letter of Findings found that the taxpayer was not "carrying communications" but was merely an intermediate service provider. In addition, the Letter of Findings determined that an exemption claimant could only succeed if the claimant, on a "transactional basis," could determine the interstate or intrastate nature of each individual phone message. Because – according to the original Letter of Findings – taxpayer was not billing its customers on a per call basis but was carrying bulk, undifferentiated phone communications, the taxpayer was not entitled to the exemption.

Taxpayer is indeed providing bulk communication services to "primary" long distance carriers. It may be even fair to describe taxpayer as an intermediate telecommunications carrier. However, that does not alter the act that the taxpayer is – by any means used to define that term – "carrying" communications from one geographic point to another geographic point. That the originator of those telecommunications is a primary long distance carrier rather than a single, identifiable customer, is a distinction nowhere to be found – either explicitly or implicitly – within 45 IAC 1-1-124(b). That the taxpayer is an "intermediate" carrier of bulk communications, does not alter the fact that taxpayer can readily distinguish income it receives from carrying intrastate (Indianapolis to Bloomington) communications from that income derived from carrying interstate (Indianapolis to Chicago or Cleveland to Chicago) communications.

Under the plain words of the regulation, there is no requirement that a telecommunications carrier deal directly with the originator of each phone call and with each and every recipient of that same phone call. To impose such a requirement would add an additional mandate found nowhere within 45 IAC 1-1-124(b) and would ignore the technological and structural changes which have transformed the telecommunications industry. The days when the individual telephone customer would contract with a single phone carrier to install the customer's equipment, receive every phone message the customer originated, and carry – in toto – the consumer's phone calls to each and every one of the ultimate recipients, are long past.

The audit and the original Letter of Findings found that taxpayer was merely an intermediate "service provider," removed from the actual business of "carrying communications." A reasonable argument can be made that certain vendors – though peripherally involved in the telecommunications business – are simply "service" providers not involved in "carrying communications" and, as such, certainly not entitled to the regulatory exemption. Such vendors might include those who originally built and installed taxpayer's microwave equipment, vendors who provide taxpayer with billing or accounting services, or independent contractors which

maintain and repair taxpayer's equipment. Clearly, taxpayer is not simply peripherally involved in "carrying communications." Taxpayer constructed its microwave system and exists to "carry communications" between two distinct geographic points. If taxpayer would be removed from the network infrastructure, the communications which travel through taxpayer's system would – until an alternative was provided – not be "carried" and the originators' messages would not be received at the their intended destinations.

The original Letter of Findings determined that taxpayer was not entitled to exemption because it could not compute its gross income on a "transactional basis." Because taxpayer could not determine the exact point of origin and terminus of each individual phone message, taxpayer could not claim the 45 IAC 1-1-124(b) exemption. However, the requirement that taxpayer be able to calculate its gross income on a transactional basis adds a level of complexity and specificity nowhere to be found in the plain words of 45 IAC 1-1-124(b). Although tax exemptions are to be strictly construed against the taxpayer, it is also true that such exemptions are not to be interpreted so narrowly as to obscure the legislative purpose of the exemption. Indianapolis Public Transp. Corp. v. Indiana Dept. of State Revenue, 512 N.E.2d 906, 908 (Ind. Tax Ct. 1987). Although it is true that taxpayer cannot peer into its microwave transmissions and determine that origin and terminus of each individual phone call, it is also true that the taxpayer can precisely delineate the income received from the interstate transmission of communications from that income received from the intrastate transmission of communications. Taxpayer enters into contracts with primary carriers (LATA's) to provide service along specific geographic segments of its microwave system. The primary carriers pay taxpayer to use an interstate segment such as Indianapolis to Chicago. Another primary carrier will pay taxpayer to use an intrastate segment such as the segment between Indianapolis and Bloomington. There is no ambiguity in determining what portion of taxpayer's income is "derived from carrying communications between two (2) points in Indiana." 45 IAC 1-1-124(b). There is no ambiguity in determining what portion of taxpayer's income is "derived from carrying communications between a point outside Indiana and a point in Indiana, or from a point outside Indiana into and across the State to a point outside Indiana." Id.

Accordingly, to the extent that taxpayer can specifically differentiate between the income it received for carrying intrastate communications linking two points within the state (e.g. Indianapolis to Bloomington) from the income it received for carrying interstate communications (e.g. Indianapolis to Chicago), taxpayer is entitled to claim the exemption available under 45 IAC 1-1-124(b).

FINDING

Taxpayer's protest is sustained.

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